

Weekly Fixed Income Summary: *Brexit Boosts EM's After Initial Shock*

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Bonds Outlook. We expect bond yields to remain depressed as bonds rally this week following post-Brexit investors' diaspora. As it turns out, the Philippines proved to be resilient from the shockwaves caused by U.K.'s vote to exit the European Union as the Philippines' exposure to the U.K. or the E.U. was limited, making it quite attractive to investors seeking safe haven. This was reflected in last Tuesday's (June 28) Php25bn auction of 4-yr bonds with 3.375% interest by the Bureau of Treasury, which was more than three times oversubscribed at Php89bn. This is a sign of investors' confidence in the country's long-term prospects.

The past week also saw the inauguration of Pres. Rodrigo Duterte, further bolstering investor confidence with his promise of increased government spending, relaxation of foreign ownership of corporations, and progressive tax reform among others.

The BSP reported a 13.5% year-on-year (YoY) growth in domestic liquidity (M3) for May from April's 12.7%, driven by sustained demand for credit. Outstanding loans of commercial banks, net of reverse repurchase (RRP), also grew 17.7% YoY in May. The BSP is set to release the inflation rate/CPI tomorrow, July 5, which is expected to be higher but would be a non-factor for interest rates. Lastly, government would be borrowing Php135bn from the domestic market for the third quarter, the same amount as the last quarter. Hence, the fact that borrowing is still the same despite expected higher inflation and strong liquidity will help sustain the rally in bonds.

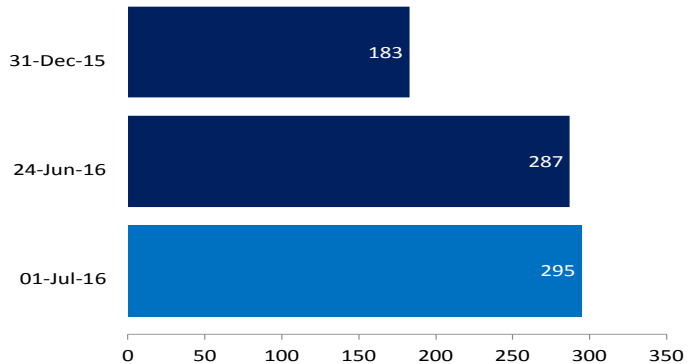
Total daily traded volume balloons by 528% to Php28bn. The liquid bond yields fell by an average of 21bps as Philippine bonds became a hot commodity when investors sought cover from the fallout of the Brexit vote. The front-end (FXTN 05-72: 2.3 years) and belly (FXTN 10-60: 9.4 years) fell by 2bps and 24bps, respectively, to 2.41% and 3.26%, while the long-end (FXTN 25-11: 24.6 years) also fell by 23bps to 4.32%. Trading was very lopsided, favoring the heavy buying of T-bonds with total value traded at Php27.8bn, up 600% week-on-week, while T-bills rose by just 4% to Php570.6mn.

Emerging Markets' (EM) 10-year yields fall 34bps, WoW. The 10-year yields of EMs we follow fell by an average of 34bps, WoW, led by Turkey (10-year yield -67 bp), Colombia (-51 bp), and Russia (-43 bp), while Peru (10-year yield flat), Taiwan (-2 bp), and China (-3 bp) were the underperformers. It appears that the Brexit vote triggered a rally for EMs, who have been easing monetary policies ahead of the vote. This is a complete reversal of the pre-vote assessment that EMs were the most vulnerable following a U.K. exit. Post-Brexit shock has started to wane, and the realization that the uncertainty

may keep the U.S. Fed sidelined until the end of the year and the disruption in trade boosted emerging markets' currencies, stocks, and sovereign bonds. Latin American currencies, in particular, have been hitting peaks, with the Chilean peso hitting its 12-month high during the day last Friday at 657.93/dollar and the Brazilian real reaching its strongest at 3.2522/dollar intra-day on Wednesday.

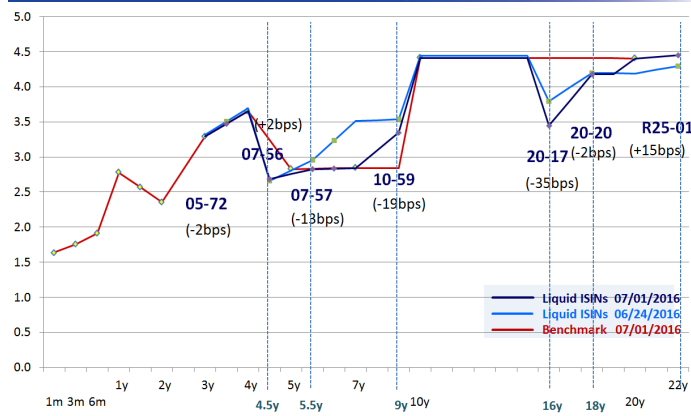
US Generic Yield Curve falls 4bps, WoW. The US treasury yield curve fell by an average of 4bps last week amid signs that the Brexit vote will slow global economic growth and prevent the Fed from raising rates this year. Global investors BlackRock, Guggenheim Partners, and Vanguard Group, Inc. said that the Brexit vote would spell lower yields and subdued growth in global markets as advanced economies move to prevent global economic contagion. The U.S. joined the global bond markets' rally last week, with Switzerland's yield reaching below-zero levels, German 10-year bonds gaining again for the sixth week as even sub-zero yields attracted investors to the debt, Japan posting record-low yields below zero, and the Bloomberg Global Developed Sovereign Bond Index reaching a record-low of 0.45%. So far, there has been few evidence of a yield reversal; the question of a Fed rate hike has altered from when to if, and some futures traders even betting on a cut instead of a hike. ▲

PH and US Treasury 10-Yr Spread (bps)



Source: Bloomberg

PDST-R2 Rates of Liquid Government Securities



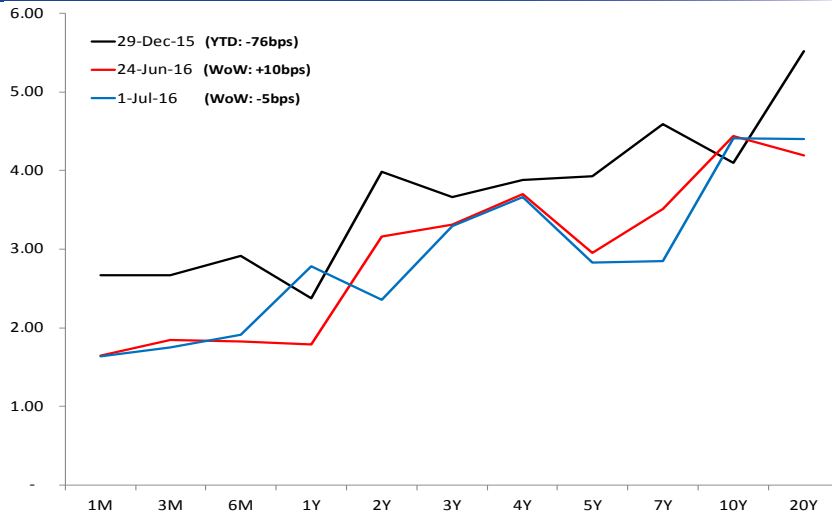
Source: PDS

High Yield and Emerging Markets 10-yr USD Yield

	24-Jun	1-Jul	Dec 2015	YTD Change
Chile	2.50	2.25	3.08	(83)
Philippines	2.25	2.05	2.98	(93)
Mexico	3.12	2.71	3.81	(110)
Peru	2.98	2.68	4.09	(141)
Colombia	3.61	3.20	4.67	(147)
Indonesia	3.78	3.51	4.70	(120)
Turkey	4.38	4.02	5.02	(99)
Brazil	4.94	4.40	7.15	(275)

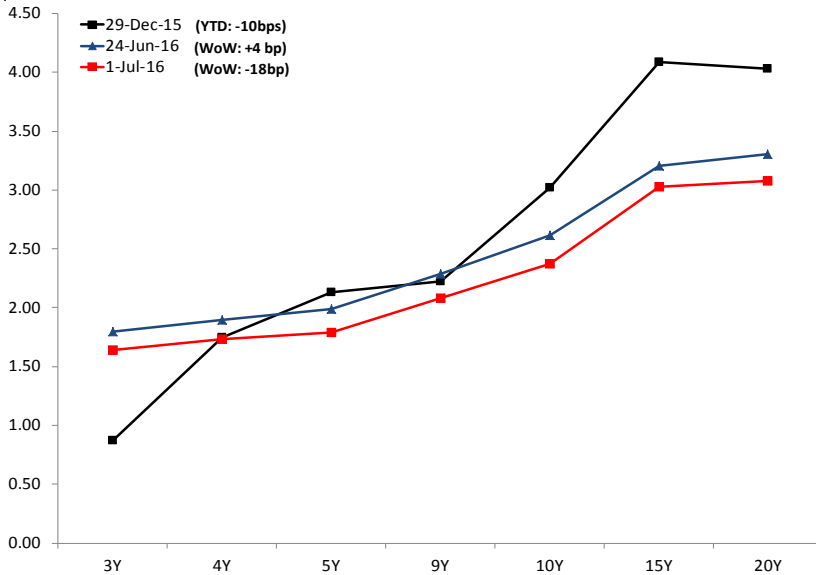
Source: Bloomberg

Philippine Php Yield Curve, PDST-R2



Source: Bloomberg

USD Philippine Sovereign Curve



Source: Bloomberg

Primary Indicators

	Period	Latest Period	Preceding Period
I. Real Economy (Growth, %)			
A. GDP	1Q2016	6.9	6.3
B. Manufacturing (VoPi)	Apr '16	10.5	7.8
II. Monetary and Banking			
A. Outstanding Loans, net of RRP (Php Bn), UKBs	May'16	5,322	5,216
Y-O-Y Growth (%)	May'16	17.7	15.6
B. NPL to Total Loans	Apr'16	1.68	1.72
C. M3 Growth (Y-O-Y)	May'16	13.5	12.7
III. Prices			
A. PHP/USD (PDS data)	1W July '16	47.007	46.130
B. 91-Day Rate (%)	1W July '16	1.588	1.674
C. 10-Yr Rate (%)	1W July'16	4.411	4.442
D. Inflation (%)	May '16	1.6	1.1
E. RRP	May '16	3.000	4.000
F. SDA Rate	Sept '14	2.500	2.250
IV. External Accounts			
A. Balance of Payments (USD m)	May'16	241	184
YTD (USD b)		216	-25
B. Net Foreign Portfolio Inv (USD m)	May '16	73	-354.1
C. OFW Personal Remittances	Apr '16	2,443	2,606
Y-O-Y Growth		3.8%	1.4%
D. Gross Intl Reserves (USD b)	May '16	83.5	83.7
E. Import Cover (x)	May '16	10.4	10.5
F. ST External Debt Cover (x)	May '16	5.4	5.5
G. Exports Growth (YoY)	Apr '16	-4.1	-4.7
V. NG Cash Operations			
A. Surplus (Deficit) (Php bn)	Apr'16	55.0	(74.4)

US Treasury Yields (Constant Maturity)

	24-Jun	1-Jul	1 Week (bps)	YTD (bps)
3M	0.27	0.28	1	12
6M	0.38	0.37	(1)	(12)
1Y	0.48	0.45	(3)	(20)
2Y	0.64	0.59	(5)	(47)
3Y	0.76	0.71	(5)	(60)
5Y	1.08	1.00	(8)	(76)
10Y	1.57	1.46	(11)	(81)
20Y	1.96	1.81	(15)	(86)
30Y	2.42	2.24	(18)	(77)

Source: Bloomberg